

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 EB-07 TRSE-00 L-03 CIAE-00 INR-07

NSAE-00 COME-00 AID-05 FRB-03 SS-15 NSC-05 /056 W

----- 128072

R 302240Z MAY 75

FM AMEMBASSY MANAGUA

TO SECSTATE WASHDC 7092

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E. O. 11652: N/A

TAGS: EGIN, EINV

SUBJECT: GON REQUESTS VISIT OF U.S. TAX EXPERT TO DISCUSS

TAXATION ON FOREIGN BANKS IN NICARAGUA

1. VICE MINISTER OF FINANCE RUBEN GARCIA HAS FORMALLY ASKED THAT A USG TAX EXPERT VISIT NICARAGUA TO EXCHANGE VIEWS WITH GON OFFICIALS ON TAXATION OF INTEREST RECEIVED BY FOREIGN BANKS HERE. AN EXPERT FROM U.S. PRIVATE BANKING SECTOR TO PARTICIPATE IN THE DISCUSSIONS IS ALSO WELCOME.

2. A GON MEMORANDUM ACCOMPANYING THE REQUEST STATES:  
AS YOU MAY ALREADY KNOW, THE TAX SYSTEM OF NICARAGUA HAS RECENTLY BEEN REFORMED BY ACT OF CONGRESS ENACTED NOVEMBER 23, 1974. THE REFORM INCLUDES SUBSTANTIAL MODIFICATIONS TO THE INCOME TAX SYSTEM, WHICH WILL ENTER INTO EFFECT JANUARY 1ST, 1975. SOME OF THE PROVISIONS AFFECT THE TAX LIABILITY OF INTEREST INCOME RECEIVED BY FOREIGN BANKS. ARTICLE 14 OF THE INCOME TAX LAW READS AS FOLLOWS:

QUOTE

WHEN, IN ACCORDANCE WITH PARTS I), J) AND K) OF THE PREVIOUS SECTION, THE BANK OR FOREIGN INSTITUTIONS ARE EXEMPTED FROM TAXES ON THE INTEREST EARNED, THE FOLLOWING RULES WILL APPLY:

A) THE EXEMPTION WILL APPLY IF THE HOME COUNTRY OF SAID BANK DOES NOT TAX SUCH INTEREST WITH INCOME TAX OR IF IT TAXES THE LIMITED OFFICIAL USE

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INTEREST WITHOUT GRANTING CREDIT FOR TAXES PAID TO NICARAGUA; AND

B) IF THE BANK'S HOME COUNTRY TAXES SUCH INTEREST BUT CREDITS THE BANK FOR TAXES PAID TO NICARAGUA, THE EXEMPTION SHALL BE CONSIDERED SUSPENDED AS LONG AS THIS SITUATION PREVAILS, AND CONSEQUENTLY THE INTEREST EARNED SHALL BE AFFECTED BY THIS TAX. THE RULES CONTAINED IN THE ABOVE PARTS A) AND B) SHALL BE APPLIED IN GENERAL TO ALL INCOME ORIGINATING IN NICARAGUA EARNED BY INDIVIDUALS OR PRIVATE CONCERNS RESIDENT IN FOREIGN COUNTRIES, WHICH ARE EXEMPT UNDER THIS LAW OR UNDER ANY LAW OF A GENERAL NATURE. END QUOTE

THE OBJECTIVE OF THE ABOVE-MENTIONED PROVISIONS IS TO ELIMINATE A TAX SACRIFICE IN A SITUATION WHERE TAX EXEMPTION DOES NOT INVOLVE A REAL BENEFIT TO THE LENDER BANK IN SUCH A SITUATION ACCORDING TO THE PROVISION THE TAX HOLIDAY GRANTED TO THE BANK BY NICARAGUA IS NOT APPLICABLE AS LONG AS THE SITUATION PREVAILS. IT SHOULD BE NOTED THAT THE TAX EXEMPTION IS NOT ABROGATED, ONLY ITS EFFECTS ARE SUSPENDED, AND, THEREFORE, IT BECOMES APPLICABLE AS SOON AS THE SITUATION CHANGES. THE SITUATION IS TYPICAL OF A BANK WHOSE COUNTRY OF RESIDENCE TAXES WORLDWIDE INCOME AND AVOIDS DOUBLE TAXATION BY PERMITTING TO CREDIT FOREIGN INCOME TAXES AGAINST DOMESTIC TAX.

IF SITUATIONS WHERE THE COUNTRY OF RESIDENCE OF THE FOREIGN BANK DOES NOT TAX INCOME FROM ABROAD OR IT APPLIES A WORLDWIDE APPROACH WITHOUT RELIEF FOR DOUBLE TAXATION, THEN, THE EXEMPTION IS FULLY APPLICABLE, THE REASONING BEING THAT IN THE FIRST SITUATION THE LENDER BANK DOES NOT BENEFIT FROM THE TAX EXEMPTION SINCE IT WINDS UP PAYING THE SAME AMOUNT OF TOTAL TAXATION WHETHER IT PAYS TAX OR NOT TO NICARAGUA. IT BECOMES OBVIOUS THEN THAT THE NICARAGUAN GOVERNMENT SHOULD TAX INTEREST INCOME DERIVED FROM NICARAGUAN SOURCES. THE AMOUNT PAID TO NICARAGUA IS INDIFFERENT TO THE BANK AS LONG AS IT DOES NOT EXCEED THE COUNTRY OF RESIDENCE TAX. OTHERWISE, THAT IS, SHOULD THE NICARAGUAN GOVERNMENT EXEMPT FROM TAX INTEREST INCOME IT WOULD ONLY INCREASE TAX PAYABLE TO THE RESIDENCE COUNTRY OF THE BANK, THUS NULLIFYING THE TAX EXEMPTION SO GRANTED.

ONE INTERESTING FEATURE OF THE SCHEME SHOULD BE NOTED. AS ALREADY MENTIONED, EXEMPTIONS GRANTED BY LAW IN CONDITIONS THEREIN LIMITED OFFICIAL USE

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ESTABLISHED CONTINUE TO BE LEGALLY VALID, ONLY ITS EFFECTS ARE SUSPENDED BUT ONLY FOR AS LONG AS THE TAX STATUS OF THE FOREIGN COUNTRY TAXES INTERESTS ORIGINATING IN NICARAGUA AND ALLOWS A CREDIT, FOR TAX PAID TO NICARAGUA.

IT SHOULD BECOME APPARENT THAT IN A SITUATION WHERE THE COUNTRY OF RESIDENCE OF THE FOREIGN BANK DOES NOT TAX WORLDWIDE INCOME AT ALL OR IF IT TAXES SUCH INCOME WITHOUT AVOIDING DOUBLE TAXATION

THE EXEMPTION GRANTED BY NICARAGUA BENEFITS THE FOREIGN BANK  
IN FULL.

THEREFORE IN THOSE SITUATIONS THE EXEMPTION REMAINS APPLICABLE.  
AS IT CAN BE SEEN, THE NEW LAW IN THIS RESPECT HAS MADE AN  
ACCOMMODATION OF THE TAX HOLIDAY TO INTERNATIONAL TAXATION, WITH  
NO IMPAIRMENT TO THE FAVORABLE AX TREATMENT THAT NICRAGUA HAS  
TRADITIONALLY OFFERED FOREIGN BANKS DOING FINANCIAL OPERATIONS IN  
NICARAGUA.

3. GARCIA MENTIONED THE NAME OF STANLEY SURREY, WHO WORKED FOR  
MANY YEARS FOR DEPARTMENT OF TREASURY AS KNOWLEDGEABLE IN THIS FIELD.

4. EMBASSY WOULD APPRECIATE A POSITIVE RESPONSE TO THIS REQUEST.  
WE BELIEVE EXPERT MIGHT ALSO USE OPPORTUNITY TO DISCUSS PROS AND  
CONS OF A DOUBLE TAXATION AGREEMENT WITH U.S. MINISTRY OF  
FINANCE OFFICIAL HAS EXPRESSED HIS OPINION THAT STANDARD TREATY  
DISCRIMINATES IN FAVOR OF U.S.  
SHELTON

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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** BANKS, TAXES, CONSULTANTS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 30 MAY 1975  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** GolinoFR  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1975MANAGU02083  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Film Number:** D750190-0879  
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**Office:** ACTION ARA  
**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 3  
**Previous Channel Indicators:** n/a  
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**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** GolinoFR  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 10 SEP 2003  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <10 SEP 2003 by ellisoob>; APPROVED <11 SEP 2003 by GolinoFR>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
05 JUL 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** GON REQUESTS VISIT OF U.S. TAX EXPERT TO DISCUSS TAXATION ON FOREIGN BANKS IN NICARAGUA  
**TAGS:** EGEN, EINV, NU, (GARCIA, RUBEN)  
**To:** STATE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006